DOW THEORY LETTERS INC.

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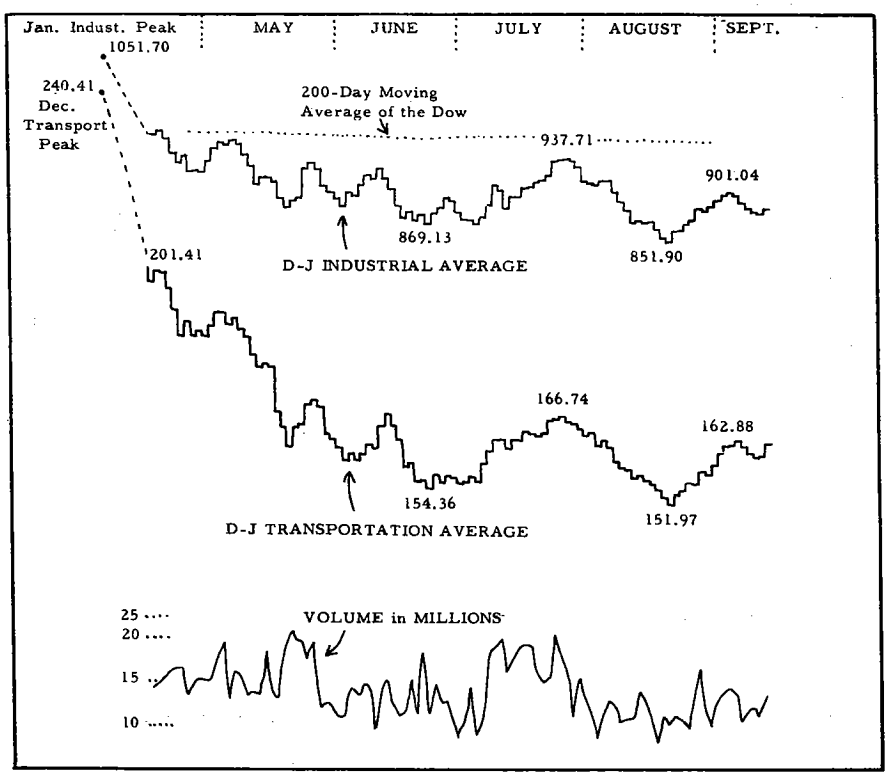
CORRECT RESPONSE: It is said that all financial trends begin on the East Coast and move west; all social trends start on the West Coast and move east. With that principle in mind, East Coast readers might study this little ad from a current San Diego newspaper. Is this ad telling us something about a correct response to today's world? (Veteran readers know, of course, that I'm only kidding!).

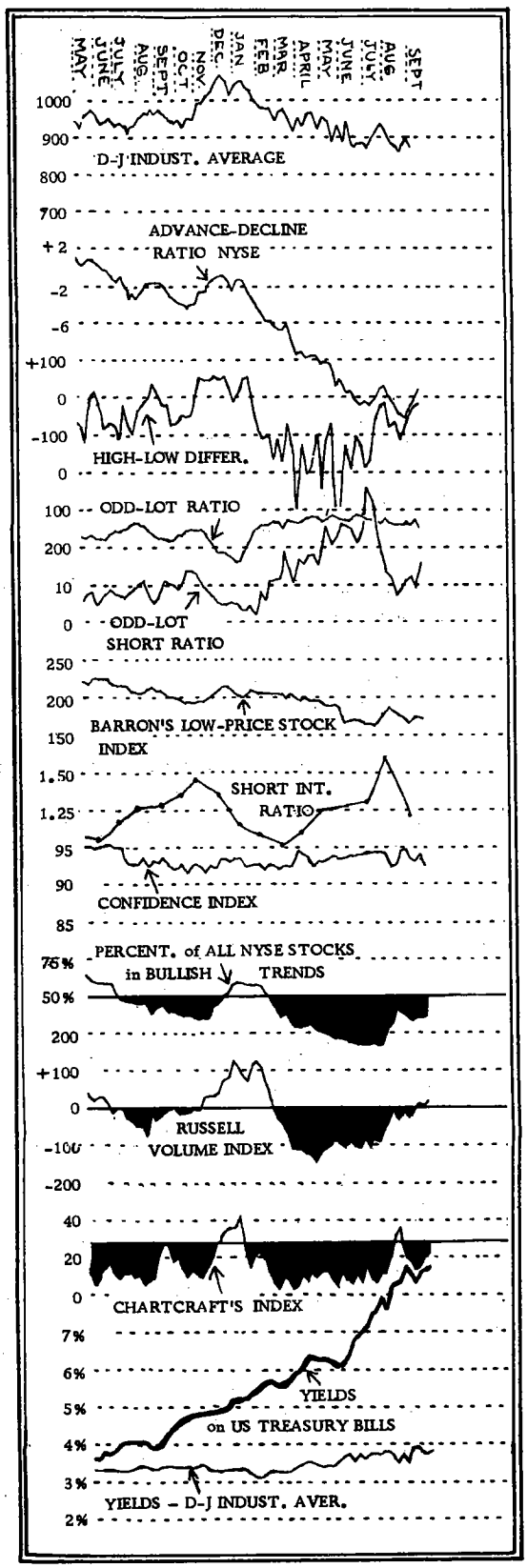
INSULATE YOURSELF, at will, against life's trials and tribulations by Gomer Beansod's technique of complete numbness as outlined with consummate clarity in his new book THE THERAPY OF COMPLETE NUMBNESS AND HOW TO INDUCE IT. Details from Numbness, Unltd,, Box 452, Nestor, Calif. 92053.

THE PICTURE: People wonder why Wall Street tries so hard to be perpetually bullish. Wall Street's job is the distribution of stocks, and if people aren't optimistic they are hardly going to be standing in line to buy a piece of America or its corporations. Actually, what most of the citizens I talk to would like to buy is a little peace of mind, as if such a thing were possible in this age of changing menus, price lists and supermarket tags (need I comment as to which direction they are changing?).

On September 11 the Wall Street Journal ran an article on the whopping $53 million August loss sustained by NYSE member firms. That's the kind of depressing fact that makes the Street sit back and dream of the good old days when everybody actually believed their own bullish pronouncements. So much so, in fact, that around 1968 Wall Street geared up for NYSE volume of around 20 million shares a day. Now, with volume running in the 10-12 million share zone, the trouble has arrived.

As I have said many times before, one characteristic of a primary bear market (and we are now in one) is contracting volume. That, unfortunately, is a fact of





life that Wall Street cannot seem to understand (thus, the absurd boosting of commission rates rather than the necessary cutbacks). Another characteristic of primary bear markets is that they are international in scope. I was therefore not too surprised (last week) when a British subscriber sent me a clipping which stated that volume on the London exchange during August was the lowest since late-1970. Thus, our overseas cousins are sharing the same problems that we face, soaring interest rates, inflation, currency uncertainties, controls, "phases" and ebbing confidence. I will probably run my chart of leading foreign stock markets around once a month from here on (see Letter 572), because I feel that the entire international picture is now more intertwined than every before in history. And there is no better way of taking the international financial "temperature" than by scrutinizing the various stock averages.

Turning to Wall Street itself, I noted in the last Letter that (under Dow Theory) we now have two excellent "marker points" with which to check the near-term trend. On August 22 (see page 1 chart) the D-J Industrials and Transports struck simultaneous lows of 851.90 and 151.97. I would say that as long as one or both of the Averages hold above those levels, it is fair to assume that the secondary trend is up. Obviously, if any decline takes both Averages below their August lows, it would be a signal for a bearish resumption of all three market trends, primary, secondary and minor.

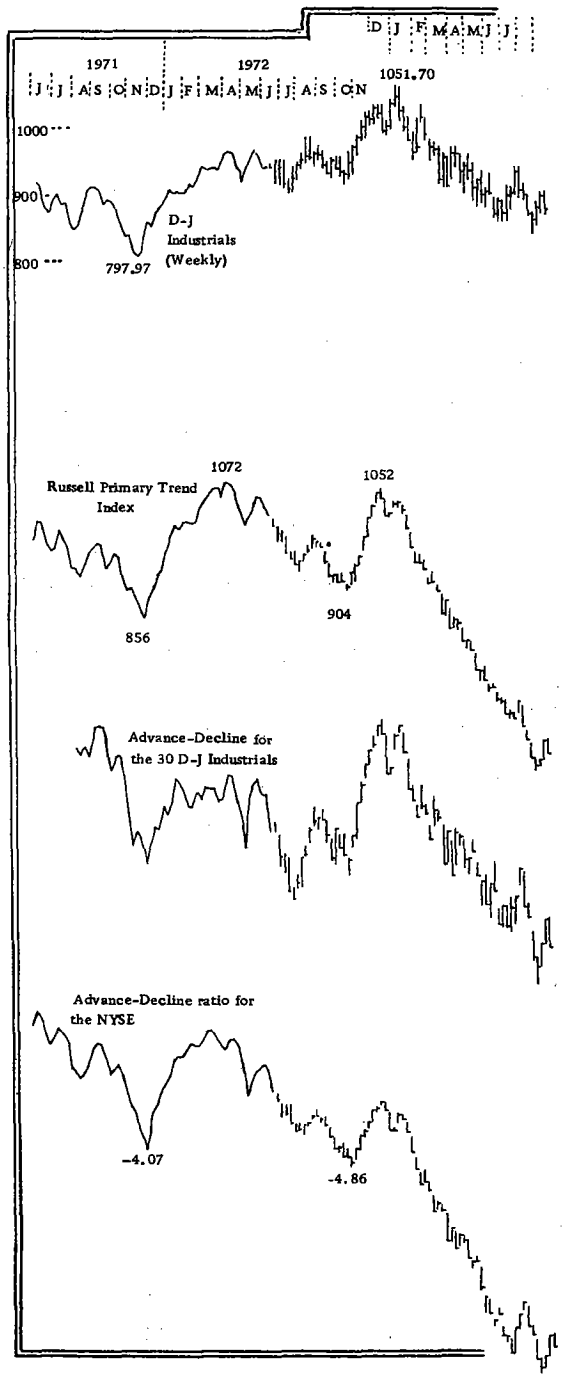
I called attention in Letter 573 to the simultaneous new lows of August 22, and I noted that most important bottoms are established with non-confirmed lows, not simultaneous lows (in other words, one Average will sink to a new low unconfirmed by the other). Thus, if the August 22 lows represent an important secondary bottom, it would be a rather atypical situation.

On the upside we also have significant reference points, the 901.04 Industrial peak of September 6 and the 162.88 Transport high of September 7. Any forthcoming rally which could generate sufficient steam to take the Averages above those highs would also have the distinction of signalling a bullish extension of the secondary trend.

I am including my weekly chart of the Dow Industrials and three important indicators which I follow (these statistics are computed daily but charted weekly). On the sudden decline from the September 6 peak, the Primary Trend Index (PTI) produced large daily loss figures. This is very unusual action considering that the loss figures appeared right off the top of a fresh rally. The history of the PTI indicates that this index is generally very reluctant to react during an authentic upswing (note the action of the PTI during the 1971 advance and again during the late-1972 advance — it hardly budged on the downside). Therefore, I would say that the pattern of the PTI since September 6 renders the latest market rally quite suspect. Remember, if the Dow does manage to rally to a new peak (above the September 6 high of 901.04), the PTI must confirm — or trouble can be expected shortly.

The advance-decline index for the 30 Dow Industrials does not look particularly impressive and it is still under its 1971 low (at which time the Dow was 797). Finally, the A-D ratio for the entire NYSE still provides one of the best guides to the trend of the majority of stocks on the Big Boards. As you can see, there is no real evidence here to suggest that the majority trend is up, only the possibility (since the A-D ratio is above its August low) that the worst "may have been seen."

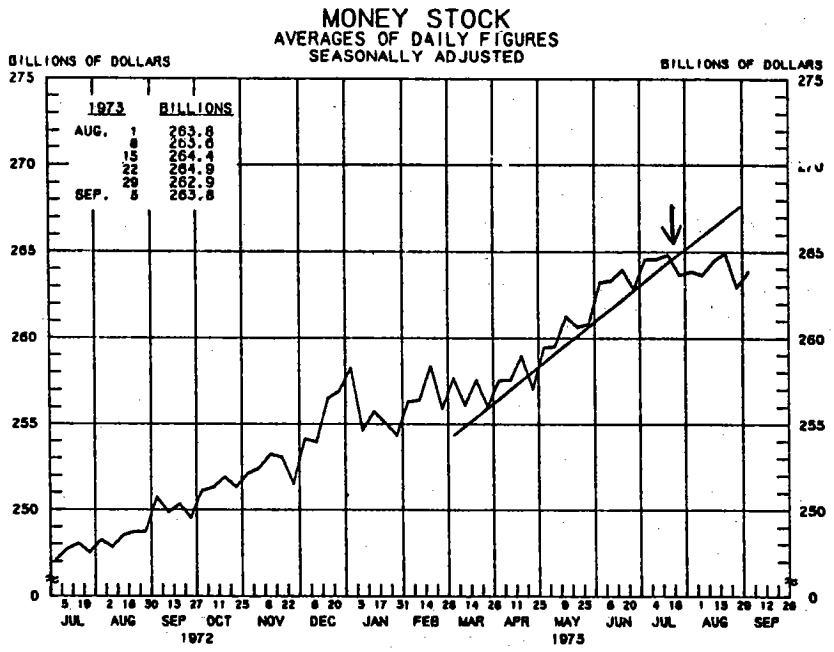
In the last report I presented a study of my two most-active stock indices, MAS and CMAS (new readers, PLEASE save back issues of DTL's for reference). I said that these two indicators had proved most helpful in gauging the intermediate market trend. On September 6 MAS climbed to plus 42, thereby throwing this indicator into the high plus side for only the second time this year. MAS then dropped back to minus 2 on September 13, but we are now pushing to the plus side again. This is hopeful for the near-term trend. The cumulative index (CMAS) is also looking better, and a few more days of most-active pluralities on the upside could provide the first upward zig-zag



on this index in 1973. Thus, the volatile action on the NYSE is swinging to the upside, and this is definitely ammunition for the bulls.

In his latest report, Harry Schultz talks about a few months of euphoria coming up in 1973. He feels it will be "...like a spurt of adrenalin that often shoots through the body of a man about to die... and just as a body can't survive adrenalin working over-hard, neither can the body-economic." If the most-active indices are pointing to an awakening of bullishness (which could well be the case), I would go along with Harry's analysis. In a phrase, the best we're going to see is a temporary parting of the storm clouds, not a health cure. For as of this writing nothing's been solved, nothing's been corrected, nothing's been thought out. I repeat — nothing.

MONEY, INTEREST RATES, GOLD: In the last report I said that the biggest game on Wall Street at present was guessing whether interest rates had topped out or not (which is another way of guessing whether the bond market has bottomed). So far, Wall Street has made the "answer" appear absurdly easy. The bond market has rallied, the Utility Average is well off its low, Municipals are higher. And don't worry about the Federal Reserve Board, they always back down after giving it the old college try, particularly if a strong President leans on them a little.



But what's this? Here comes Fed Chairman Burns upping the bank reserves needed on big C/D's to 11%, following May's rise to 8% (up from a previous 5%). And on September 10, 91-day Treasury bills leapt to a record 9% yield! That's bad enough, but on the same day Burns stated, (WSJ, Sept. 10): "By now, even skeptics in the financial community should be convinced that the Fed won't flinch in its determination to moderate substantially the pace at which money and credit supplies have been expanding." All of which means, as the WSJ puts it, that the new credit restrictions by the Fed "...indicates that the Fed is still far more worried about inflation than high interest rates."

Of course, alot of us have learned to distrust almost everything the President, the Secretary of the Treasury, the Chairman of the Federal Reserve Board or anyone else announces. We've all been fed too much pap for too many years, and the fact is that inflation is still roaring and prices are still going through the roof. But then we turn to this week's St. Louis Federal Reserve Bank chart of the money stock (see chart), and mmmm, Mr. Burns just may not be kidding. With interest rates still sky high, the money stock is heading down! So far, we know that the Fed has attempted to fight this year's horrendous inflation with record interest rates but an ample supply of money. What happens (and we must assume the chart is telling us what the Fed is attempting to do) if the Fed now puts the squeeze on the aggregates, the money stock and the actual money supply?

Personally, I think the Fed is far more serious about halting inflation than Wall Street gives it credit for being. If the chart is correct, if the trend of the money supply itself is now down (in the face of business loans which are now rising at a 20% year-to-year rate), well we might just get stage two of the crunch, and stage two could be a monster. On September 13 California's giant Well Fargo Bank harkened back to its pioneering tradition by being the first in the nation to boost the prime rate to an even 10%. And even my subscribers from South America know that that is tight money...

* * * *

With commodities now heading south (following their recent hysterical blow-off), with Wall Street itself in depression, I note another and much larger area of severe trouble. Housing and construction has run into a brick wall due to mortgage rates which are into the stratosphere and the general unavailability of mortgage money at any price. Eliot Janeway in his Sept. 4 Janeway Letter notes that overbuilding is the prevailing situation for 1973. "If ever the real estate market needed a helping hand with easy mortgage money," he writes, "it has been this year." So far, inflation has "held up" the price level in housing. But high-priced real estate with no buyers constitutes a dangerous situation (as do, for instance, high-priced glamor stocks in the face of low volume on Wall Street).

Turning to my monetary chart, we see a most interesting picture. We have an initial rally in the D-J Utility and 40-Bond Averages, and while nothing can be proved by the first rally following a long decline, the rallies "could mean" that the bottoms have been seen. If so, we have the seeds of a better monetary picture.

"Will Go," our indicator friend with (hopefully) the crystal ball, has us on notice that the Dow should head generally down between the end of August and the first week in November. In early November we have an upward zig-zag. So between now and the first week in November, we will have ample time to check Will Go's perspicacity.

Finally, the index of the ratio of the yields on Aaa corporate bonds and T-Bills sank last week to a new low of .87. Remember, anytime this ratio is below 1.0 (as now), we have a "freak" period in which bond yields are below short-term or T-Bill yields. During such periods in the past the market has been under pressure, and it has declined. At .87, the ratio is sadly out-of-kilter, and it is saying that the need for short-term money is so intense that short-term rates have actually surpassed long-term rates (for only the sixth time in history). If the money crunch is over, we should be getting higher readings on the Aaa/T-Bill ratio, not new lows, and that's all I can say in my interpretation of this ratio.

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Could this be a preview of things to come? The Government has just announced that 60 thousand college students have defaulted on $55 million of federally guaranteed loans over the past five years. Deputy Commissioner Muirhead stated, "We are having trouble collecting on the guaranteed student program... I would be less than candid if I didn't acknowledge the fact that we are very worried about this problem." Some day, I intend to figure out how much assorted real estate, housing, machinery, livestock, railroads and Lord knows what Uncle Sam has guaranteed. If times get rough, I wonder who's going to guarantee Uncle Sam. Anyone know?

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The IMF has come out in its annual report with a (we'll have to call it belated) warning regarding spiraling world inflation. It stated that Mr. Nixon faces "an exceptionally difficult path" in guiding the US back along the line between boom and recession (I'd call that a modest presentation of the problem). Significantly, the report said that exchange rates based on agreement, rather than day-to-day currency "floats" are needed. All of which brings us to the subject of gold.

First, let me note that alot of bunkum is going around regarding the new Congressional bill which would make it legal for US citizens to own gold. The bill states that there must be a final OK as to timing by the President of the United States. Well, with Treasury Secretary Shultz, who does not understand gold, and Under-Secretary of the Treasury Volcker, who hates gold, in the saddle, the bill to me is almost worthless. Mr. Nixon seems always to be guided by his "appropriate experts," and as long as he retains his Treasury experts I give the gold bill no chance of passing the Presidential signature requirement.

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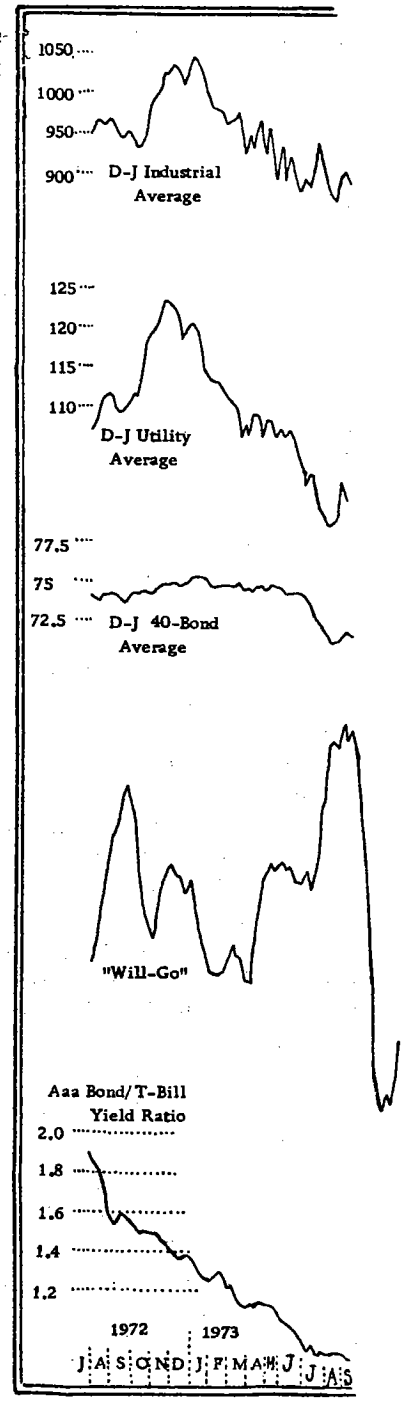
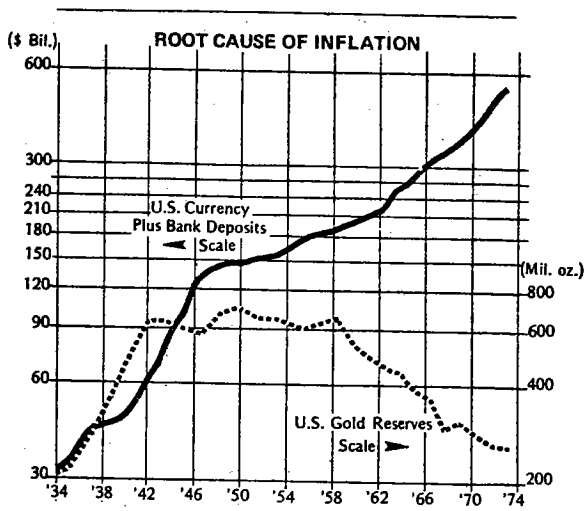
The Holt Advisory (277 Park Ave., NYC 10017) has another of its exceptionally interesting gold pieces in the Sept. 7 report. In that issue, Holt shows that the growth of the "big 10" nations' money supply increased about 5% to 8% a year from 1963 to 1969. In 1970 the money supply of the leading nations increased about 10%, in 1971 supply boomed 19%, in 1972 about 17%. The actual total over the decade rose from about $280 billion to about $640 billion. During this time gold reserves (in volume) actually declined!

Holt notes that the dollar accounts for most of the world's money stock (both for money here in the US and as a reserve in foreign central banks), and for this reason it is important to look at the dollar-gold relationship to see what gold is really worth today. The accompanying chart (from Holt) provides a valuable clue. Holt notes that with a 17-fold increase





in the money supply since 1934 and an (only) 40% increase in the gold supply, it would require a price of $450 per oz. of gold to re-establish the 1934 relationship (even if inflation were to halt today). At the least (using the 1929-33 contraction as a guide) Holt sees gold worth $300 per oz.

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On September 24 the widely-heralded IMF meeting begins in Nairobi. I view it as just another potential opportunity for world monetary sanity. As things are going, more and more paper is printed against gold, and the gold-paper ratio drops lower and lower. Unless the price of gold is raised and the dollar (or some new device) is made convertible, the only alternative is a new and different "official" exchange ratio between currencies — a new IMF brand of paper. True, the IMF can come up with new names for their "paper gold" paper, but there is no way in which the IMF or anyone can get the world's citizens to accept name-brand paper as money (try escaping across an international border with an SDR or a CRU. (Frankly, I never fail to be astounded by the lies the world's monetary statesmen tell themselves in their continuing efforts to avoid the reality of the only real, totally acceptable, totally international money — gold).

At the IMF meeting the US will present its demand that nations with payments which are "out of balance" be forced to take "corrective action." This euphemism is absurd on the face of it. A nation which is producing efficiently will always attract additional reserves much as a business which is producing efficiently will make profits. The US proposes placing penalties on the efficient nations in the name of "unbalanced" payment balances. Any such economic lie, in my opinion, is doomed to failure.

Another US proposal states that SDR's or some other paper vehicle should serve as the central reserve, while gold is to be (hopefully) de-emphasized. Study the Holt chart again. Given a continuance of those trends, do you think the various nations will be ready to substitute a man-made paper reserve to stand behind the world's paper currency? You can construct a house of cards a foot high or perhaps two or three feet high. But when you try to build a card-house to the sky, you need a base of metal, not paper. And it is this that the monetary "magicians" will find out if they try to make more paper the base of a new monetary system.

Now here are my thoughts on what actually will be attempted at the IMF. I think the "big gun" nations will try to pull off a trade with the US. The gold component of the Special Drawing Rights (SDR's) will be removed, thus the US will be "thrown a bone" (Shultz and Volcker will tell the world that gold has been de-emphasized in that it has been removed from "SDR Reserves"). This, of course, will serve to make SDR's more worthless and less desirable than ever.

Second, central banks will be allowed to buy and sell gold at the free market price. If this goes through, gold will have won a gigantic victory. It will mean that a major wall against gold will have tumbled, and gold will then be on its own, standing on its merit as a reserve that will either be wanted (purchased) by the central banks or avoided (sold). I have little doubt as to whether leading central banks will build up or deplete the gold portion of their reserves. In other words, to my mind the single most important thing which could come out of the Nairobi meeting would be an agreement to free the central banks to follow their own desires regarding gold. I'll let sanity, history and the desire for survival do the rest.

ANXIETY, FREEDOM & MARKETS: In his book "Man's Search for Himself," the outstanding psychoanalyst, Rollo May, describes the consciousness of man. In the beginning, explains May, the child sees himself as "we," as part of his parents. But as the child develops (perhaps around age 4) this changes. The child "experiences himself as an idenity who is separated from his parents and can stand against them if need be. This remarkable emergence is the birth of the human animal into a person ...This consciousness of self, this capacity to see one's self as though from the outside, is the distinctive characteristic of man."

The fact is, however, that the great majority of people never really learn to separate themselves from their parents. The "shoulds" and "don'ts" which most people live by are in reality not their own shoulds and don'ts, they are the "voices" and warnings of their parents which are still "alive and working" inside their own minds.

The free man is the man who is capable of seeing the world through his own eyes. The man who is bound to the past, the neurotic, sees the world through his parents eyes or ears. How often have you heard someone say, "I hate black people" or "I hate modern art," and you suspect they are mouthing the prejudices of someone else? They are playing it safe in that they have "become" what their parents wanted them to become, literally, little conditioned copies of their parents.

This loss of freedom is almost always accompanied by deep-seated fear (slaves, whether physical or psychological slaves, live in fear since they do not posses their true selves). This fear often assumes a strange form, a desire to control everything. The greater the loss (or giving away) of self, the greater the fear and the greater the desire to manipulate and control the "dangerous world out there."

 A friend read the above and said, "Russell, you have to depend on something. No one can be totally free and totally independent. Doesn't the free man have anyone else he can depend on?" "Sure he does," I answered, "He can depend on God. Personally, in my wandering from atheism or agnosticism to my own brand of religion, I have found that the only one I can depend on is God. You can (and should) depend on many other people up to a point, but you should not ask people to be totally dependable. It is more than they are capable of in certain circumstances."

I find it extraordinary that the Gospels underscore the freedom from neurotic links to the parents, the dependence on self (and God). "It is not peace I have come to bring but a sword," states Jesus, "For I have come to set a man against his father, a daughter against her mother, a daughter-in-law against her mother-in-law. A man's enemies will be those of his own household."

Again when he was addressing a crowd Jesus was told that his mother and brothers were outside awaiting him. "Who is my mother? Who are my brothers?" he replied. He then went on to say that only those who do the will of "the Father" are his mothers and his brothers.

Obviously, Jesus was not preaching against loving one's spouse or one's relations. He was preaching for the dominance of truth, for the freedom to see the world through one's own eyes. Mindless ties to the prejudices and even the manipulation and control of one's family all militate against one's search for the truth. Seek for the innermost truth of oneself and you are simultaneously searching for the truth of God and the world and all of mankind.

All of which brings me to the subject, believe it or not, of the stock market. One of the great problems in dealing with the market is that we study, we follow our data and charts, we examine the evidence, and then we arrive at our conclusion. Once we come to a conclusion we usually want to take action. And once acting (buying or selling) we no longer control our financial fate. Whether the market then goes up or down is out of our control.

Now many people cannot stand this situation. They cannot bear putting their "hard-earned money" into the market, and then watching the market "pop all around" any way it likes. If you feel that way (and I often do) you must face the fact that man is supposed to "go with life, not control it." Man can come forth with great inventions, man can discover amazing things, man can accomplish remarkable feats, but the minute he goes against life he is heading into a brick wall.

Your best way of knowing whether you are moving with or against life is your intuition. Most people are afraid of their intuition, because it so often seems to be pointing to action which feels "dangerous" or against what is accepted or what has become a well-established way of life. Intuition, as a rule, is life, exciting, expansive. Stifling or excusing-away your intuition is the path of deadness, safety, habit, boredom. The path to advancement in this life, I am convinced, is the path of courage to get in touch with our intuition (the "inner voice") and then to follow it.

STOCK NOTES: The strongest Dow stocks in my weekly tabulations are Alcoa, Goodyear, Int. Harvester, Int. Paper, Owens-Illinois. Autos and housing stocks should be avoided. Those who remember my very long-term relative strength chart on the Auto industry (letter 564) will be interested to know that auto relative strength has dropped to its lowest level since 1946. My technical studies continue to say that there is something drastically wrong with the auto group, something of a deep fundamental nature, and that much serious trouble lies ahead for the auto industry.

Gold bullion acts as if it wants to stay above $100 per ounce, and most of the gold shares on all exchanges look as if they have seen their lows. However, a further period of base-building will probably be necessary, and during this period I continue to recommend accumulation of leading gold shares such as ASA, Dome, Campbell, Homestake, and ADR's of such golds as President Brand, President Steyn, Kloof, Vaal Reefs, West Driefontein, East Driefontein, Blyvoors, Western Deep Levels.

I do not think the recent Western Deep riot is at all comparable to the earlier black riot of 1960. Mine pay and conditions for blacks will be improved in S. Africa, and the action of the gold shares over the past week was outstanding in view of the possible fear among investors.

For those with cash in odd amounts, I suggest writing to the new Reserve Fund, Inc. at 1301 Ave. of Americas, NYC 10019. This outfit will take any amount of cash over $1,000 for a day or longer and will pay a very fat current return of well over 9%! Dividends are credited from the day of investment to the day of redemption. The fund specializes in investments which mature within a year, investments of very high safety. This is a most interesting fund, which must rate very high for safety and usefulness.

A number of the high-priced glamor issues are now in precarious shape, and one wonders how the funds and institutions will fare if the move towards the exits begins. On Sept. 17 IBM did a swandive, losing 26 points on that day. My charts of Avon Products, Polaroid and many of the drug shares have a "precarious" look, and there is going to be nothing easy about any rally from here. I would say that anyone who had the speculative fever should probably trade the strongest Dow stocks as listed above. After all, if there is a rally it will be defined in terms of the Dow. If the Dow goes up, some of the Dow stocks have to go up. My strongest Dow stocks will probably represent some of the better actors of the 30 Dow Industrials.